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CLIENT ALERT

FY 2013 National Defense Authorization Act (P.L. 112-239): Impacts on Small Business Government Contracting

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On January 3, 2012, the U.S. Congress passed the National Defense Authorization Act for Fiscal Year 2013 (“NDAA”). While the NDAA covers many issues relevant to the government contracting community at large, it also includes new, noteworthy amendments to the Small Business Act, 15 U.S.C. § 631 *et seq.*

The 2013 NDAA provides some significant changes to small business government contracting. Most importantly, the rule governing limitations on subcontracting has been revised. The new rule implements two substantive changes. First, for services contracts, the new limitation is now based on the total amount paid to the small business, not the cost of the contract incurred for personnel. The revised rule has serious implications for small business prime contractors, as they will no longer be able to exclude the cost of materials, supplies, and other non-labor costs from their subcontracting limit calculations. Second, small business prime contractors may now meet their performance requirements by subcontracting to other “similarly situated” small businesses, i.e., those either small under the same standard or participating in the same small business program. This change will no doubt help small business prime contractors comply with the first change the new rule has implemented, but they must be careful to make sure that they count only those subcontractors who are participating in the same programs, or who are also small for straightforward small business set-asides; the new rule does not allow for all small business subcontractors to fall within the exception.

Additionally, the new rule provides for some changes to the mentor-protégé programs in place within the various federal agencies. Section 1641 authorizes the U.S. Small Business Administration (“SBA”) to establish a mentor-protégé program for all small business concerns, not just the one currently employed by the 8(a) Business Development Program (“8(a) Program”) – however, the current 8(a) Program is to be the model.

A review of the small business government contracting changes found within the NDAA indicates that the government is enacting a more serious effort to actively monitor and adjust the government’s small business contracting goals, both government-wide and intra-agency. There are numerous small business contracting reporting requirements contained throughout the small business sections. For example, Section 1632 requires the head of each federal agency to submit a report at the conclusion of each fiscal year to SBA describing the extent of participation by small businesses and the justification for any failure to achieve its small business contracting goals. Additionally, there are new audit and reporting requirements placed on the U.S.

Department of Defense's ("DoD") internal audit agencies, the Defense Contract Audit Agency ("DCAA") and the Defense Contract Management Agency ("DCMA").

A summary of all the small business government contracting provisions enacted by the NDAA is provided below.

Summary of the Small Business Provisions:

Section 1611 – Role of the directors of small business programs in acquisition processes of DoD. The revised statute directs the Secretary of Defense to develop and issue guidance to ensure that the head of each Office of Small Business Programs of the DoD is a participant as early as practicable in the acquisition processes of the department. The required guidance, at a minimum, is to include advise to the Defense Acquisition Board and the Information Technology Board, and requires coordination between the chiefs of staff of the Armed Forces and the service acquisition executives and the Director of Small Business Programs in each military department as early as practical in the relevant acquisition process.

Section 1612 – Small business ombudsman for defense audit agencies. DoD must designate an independent official in DCAA and DCMA as the Small Business Ombudsman to advise the director of the respective agency on policy issues related to small business concerns; serve as each respective agency's primary point of contact and source of information for small business concerns; collect and monitor relevant data and monitor each respective agency's conduct of audits of small businesses, including data regarding the timeliness of audit closeouts and the responsiveness of DCAA and DCMA to issues and other matters raised by small businesses; and make recommendations to the Director regarding policies, processes, and procedures related to the timeliness and responsiveness of small business audits. DCAA and DCMA's Small Business Ombudsmen must be segregated from ongoing audits in the field and are not to engage in particular audits that could compromise the agencies' independence or undermine audit compliance standards.

Section 1613 – Independent assessment of federal procurement contracting performance of DoD. Within 60 days of the NDAA's enactment, DoD must "select an appropriate entity" to conduct an independent assessment of DoD's federal procurement performance related to small business concerns. The matters to be considered include:

- the "industrial composition" of companies receiving subcontracts pursuant to previous comprehensive small business subcontracting plans pursuant to prior versions of the NDAA, compared to the "industrial composition" of other contractors in the defense industrial base;
- the quality and reliability of data on small business prime contracting and subcontracting by DoD, and the reliability of the information technology systems that the Department uses to track such data;
- the negotiation and execution of small business subcontracting plans, and the degree to which proposed teaming agreements are or are not maintained through the performance of the contracts;

- the extent to which DoD adheres to current policies and guidelines relating to small business prime contracting and subcontracting goals; the extent to which DoD bundles, consolidates, or otherwise groups requirements into contracts that are unsuitable for award to small business concerns, the extent to which such bundling, consolidation, or grouping of requirements is justified, and the effects that such practices have on small business participation in contracting opportunities within DoD;
- the degree to which abuses of small business contracting and subcontracting programs result in contracts and subcontracts intended for small business concerns not being awarded to small business concerns; and
- an examination of the transition challenges faced by businesses that graduate from small business programs or grow to exceed the size standards for participation in such programs, along with specific recommendations on steps that should be taken to help ensure the continued growth and health of such businesses.

The Secretary of Defense is required to submit a report to the congressional defense committees on the independent assessment conducted under this section, to include the findings and recommendations of that assessment, including the Secretary's own recommendations for improving the DoD's small business contracting practices.

Section 1614 – Additional responsibilities of the inspector general of DoD. The NDAA requires the DoD IG to undertake external peer reviews of DoD audit agencies—DCAA and DCMA—and include in its semiannual reports to the congressional armed services committees information concerning the numbers and types of contract audits conducted by the department during the reporting period, and whether each audit agency has received a failed opinion from an external peer review or is overdue for an external peer review.

Section 1615 – Restoration of 1 percent funding for administrative expenses of commercialization readiness program of DoD. For payment of expenses incurred to administer the Commercialization Readiness Program, the Secretary of Defense and each Secretary of a military department is authorized to use not more than an amount equal to one percent of the funds available pursuant to the Small Business Innovation Research Program, although such funds are not to be used to make Phase III awards.

Section 1621 – Procurement center representatives. The Small Business Act is amended to strengthen and clarify the roles, responsibilities, and training of Procurement Center Representatives (PCRs), assigned to each major procurement center. It also requires PCRs to review agency insourcing decisions and bundling or consolidation activity affecting small businesses, including barriers to small business participation in federal contracting.

Section 1622 – Small Business Act contracting requirements training. Within one year after the date of the NDAA's enactment, this section requires the Defense Acquisition University and the Federal Acquisition Institute to establish a course on contracting requirements under the Small Business Act, including the requirements for small businesses owned and controlled by service-disabled veterans, qualified HUBZone concerns, small businesses owned and controlled by socially and economically disadvantaged individuals, and small businesses owned and

controlled by women. Business Opportunity Specialists must obtain at least a Level I Federal Acquisition Certification in contracting or the equivalent.

Section 1623 – Acquisition planning. This section amends the Small Business Act to require that each federal department or agency provide opportunities for the participation of small business concerns, and invite the participation of the appropriate Directors of Small and Disadvantaged Business Utilization in acquisition planning processes, including access to acquisition plans.

Section 1631 – Goals for procurement contracts awarded to small business concerns. Section 1631 of the NDAA amends the Small Business Act to maintain the government-wide prime contracting goal for participation by small business concerns at not less than 23 percent of the total value of all prime contract awards for each fiscal year, and establishes goals of 3 percent respectively for total contract and subcontract awards to service-disabled veteran owned and HUBZone small businesses, and 5 percent respectively for socially and economically disadvantaged and women-owned small businesses. Each agency shall have an annual goal that presents the maximum practical opportunity for all small business participation. SBA must document an agency's decision to establish a lower goal than the government-wide level. SBA must also review and revise the goaling guidelines within 180 days after the NDAA's enactment, to ensure that agency subcontracting goals are established on the basis of realistically achievable improvements to levels of subcontracting rather than on the basis of an average of previous years' subcontracting performance, and in a manner that does not exclude categories of contracts.

Section 1632 – Reporting on goals for procurement contracts awarded to small business concerns. This section requires the head of each federal agency to submit a report at the conclusion of each fiscal year to SBA describing the extent of participation by small businesses and the justification for any failure to achieve its small business contracting goals. The SBA Administrator will annually report on overall performance on government-wide small business goals and provide the justification for any failure to achieve these goals, including a proposed remediation plan. The report will also include an analysis of the overall Federal Government and each Federal agency's number and dollar amount of prime contracts awarded to small businesses (by category, including small businesses owned by Indian Tribes, Alaska Native Corporations, and Native Hawaiian Organizations, and by NAICS code), detailing spending in the aggregate, through sole source contracts, through competitions restricted to small businesses, and through unrestricted competition.

Section 1633 – Senior executives. This section requires programs established for the development of Senior Executives to include training with respect to Federal procurement requirements, including small business contracting requirements. Agency heads must also take steps to ensure that Senior Executive members responsible for acquisition assume responsibility for the agency's success in achieving small business contracting goals through the promotion of a climate responsive to small business concerns, communicating the importance of achieving the agency's small business goals, and encouraging, small business awareness, outreach, and support.

Section 1641 – Mentor-protégé program. This section amends the Small Business Act to establish a mentor-protégé program for all small business concerns. The model for the new mentor-protégé program “shall be identical to the mentor-protégé program . . . for small business concerns that participate in the program under section 8(a),” except that SBA may modify the program to the extent necessary given the types of small business concerns included as protégés.

Mentor-protégé programs at agencies other than DoD may be approved by the SBA, and SBA shall issue regulations with respect to those programs. The regulations must address, at a minimum, eligibility requirements, types of developmental assistance to be provided, whether such assistance would affect the eligibility of the program participant as a small business due to affiliation concerns, the length of the relationship, benefits that may accrue to the mentor, reporting requirements during both participation and post-participation, whether if a mentor-protégé pair if accepted to participate in one program is therefore eligible to participate in all federal mentor-protégé programs, and actions to be taken to ensure benefits for program participants.

Current mentors and protégés with approved agreements in place will be allowed to continue their relationship according to the terms specified in their agreement until the agreement has expired.

Section 1651 – Limitations on subcontracting. The revised rule now requires prime contractors not spend on subcontractors more than 50 percent of what is paid to the concern under the contract, changing the current standard of the cost of the contract incurred for personnel. For supply contracts, small businesses may not expend on subcontractors more than 50 percent of the amount, less the cost of materials, paid to the concern under the contract. This section carves out an exception to the limitations on subcontracting calculation for “similarly situated entities,” defined as a subcontractor classified within the same small business size standard or program as the prime contractor.

Small businesses may no longer exclude the costs of materials, supplies and other non-labor costs from their subcontracting limit calculations. Small businesses are now forced to perform more work at the prime contractor level, or subcontract it to other small businesses “similarly situated” in order to remain in compliance.

Section 1652 – Penalties. This section establishes penalties for anyone violating the subcontracting limitations established in the Small Business Act.

Section 1653 – Subcontracting plans. This section requires a potential contractor to notify any potential subcontractors that it intends to include in its subcontracting plan. This section also requires agency heads to establish reporting mechanisms for subcontractors to report fraudulent activity or “bad faith” by prime contractors with respect to subcontracting plans.

Section 1654 – Notices of subcontracting opportunities. The NDAA amends the Small Business Act to allow the publication of subcontracting opportunities on appropriate federal websites as determined by SBA.

Section 1655 – Publication of certain documents. This section requires the Office of Management and Budget to publish procedures for federal agencies to use when deciding whether to convert a function being performed by a small business concern to performance by a federal employee, including procedures and methodologies for determining which contracts will be studied for potential conversion; procedures and methodologies by which a contract is evaluated as inherently governmental or as a critical agency function; and procedures and methodologies for estimating and comparing costs.

Section 1661 – Small business concern size standards. This section allows SBA to adopt new size standards, as long as the proposed rulemaking includes a detailed description of the industry for which the new size standard is proposed; an analysis of the competitive environment for that industry; the approach SBA used to develop the proposed standard including the source of data to develop the proposed rulemaking, and the anticipated effect of the proposed rulemaking on the industry.

Additionally, SBA may also establish or approve a single size standard, or “common size standards,” for a grouping of 4-digit NAICS codes only if SBA justifies that the size standard is appropriate for each individual industry classification in the grouping.

Section 1671 – Contract bundling. This provision clarifies the contract bundling requirements for construction contracts, makes other clarifying changes, and requires the Comptroller General to review and report on consolidated contracts awarded by federal agencies.

Section 1681 – Safe harbor for good faith compliance efforts. This section amends the Small Business Act to limit the liability of a small business concern acting in good faith reliance on a written advisory opinion from a Small Business Development Center or an entity participating in the Procurement Technical Assistance Cooperative Agreement Program, unless the SBA Administrator should later determine that the concern is not a small business. This section also directs SBA to issue rules defining what constitutes an adequate advisory opinion for purposes of the affected section.

Section 1682 – Requirement that fraudulent businesses be suspended or debarred. The NDAA amends the Small Business Act to clarify provisions relating to misrepresentations, business integrity, and present responsibility, and requires SBA guidance in the implementation of this section. Additionally, SBA is directed to publish and maintain on its website the current standard operating procedures for suspension and debarment, and the name and contact information for the individual designated by SBA as the senior individual responsible for suspension and debarment proceedings.

Section 1683 – Annual report on suspensions and debarments proposed by Small Business Administration. This section directs SBA to submit an annual report to the congressional small business committees detailing its suspension and debarment actions during the preceding year. The report is to include: the number of contractors proposed for suspension or debarment; the office within a Federal agency that originated each proposal for suspension or debarment; the reason for each proposal; the result of each proposal; and the number of suspensions or debarments referred to the SBA’s IG or the Attorney General.

Section 1691 – Offices of Small and Disadvantaged Business Utilization. This section amends the responsibilities of the position of the Director, including advisement on small business concerns to federal agencies, training to small businesses and contract specialists.

Section 1692 – Small Business Procurement Advisory Council. This section amends the Small Business Act’s provisions on the Small Business Procurement Advisory Council, to, among other things, identify best practices for maximizing small business utilization in Federal contracting, and submit an annual report to the Committees on Small Business of the House of Representatives and the Senate.

Section 1695 – Surety bonds. This section amends the Small Business Investment Act’s provisions dealing with the maximum bond amount, establishing \$6,500,000 as the maximum surety bond amount the government will guarantee for a total work order or contract of \$10,000,000 or less.

Section 1697 – Contracting with small business concerns owned and controlled by women. The SBA must study the various NAICS codes to identify which industries have an underrepresentation of small businesses owned and controlled by women.

Section 1698 – Small business HUBZones. This provision extends covered base closure and realignment areas as part of the definition of HUBZone areas for another five years from the date of the NDAA’s enactment.

Section 1699 – National Veterans Business Development Corporation. This section prevents the National Veterans Business Development Corporation from representing itself as federally chartered or in any other manner authorized by the Federal Government.

If you have any questions about the 2013 National Defense Authorization Act and what it may mean for you, please contact Isaias “Cy” Alba or Katie Flood at 202-857-1000 or ialba@pilieromazza.com or kflood@pilieromazza.com.